Supreme Court, U. S.
FILED
SEP 28 1977

In The

Supreme Court of the United States

October Term, 1977

No. 76-1359

BANKERS TRUST COMPANY,

Petitioner,

vs.

SAMUEL MALLIS AND FRANKLYN KUPFERMAN,

Respondents.

BRIEF FOR RESPONDENTS

NOEL W. HAUSER, P.C.
Attorney for Respondents
350 Fifth Avenue
New York, New York 10017
(212) 736-7500

10694

LUTZ APPELLATE PRINTERS, INC.
Law and Financial Printing

South River, N.J. (201)257-6850 | New York, N.Y. (212) 840-9494 | Philadelphia, Pa. (215) 563-5587 | Washington, D.C. (202) 783-7288

TABLE OF CONTENTS

	Page
Questions Presented	1
The Prologue to Fraud	2
The Anatomy of the Fraud	3
Argument:	
Introduction	6
I. Respondents clearly have standing to sue.	8
II. Bankers Trust was a "seller" of securities which were acquired by respondents.	13
III. The sale, purchase and pledge were interdependent.	14
IV. The earlier dismissal of the Supreme Court action is not *res judicata*.	14
Conclusion	17

TABLE OF CITATIONS

Cases Cited:

Architectural League v. Bartos, 404 F. Supp. 304 (S.D.N.Y. 1975)	12
Association of Data Processing Service Org. Inc. v. Campe, 397 U.S. 150, 90 S. Ct. 827, 25 L. Ed. 2d 184 (1970)	13
Birnbaum v. Newport Steel Corp., 193 F.2d 461 (C.A. 2 1952)	6

Contents

Page

Blue Chip Stamps v. Manor Drug Store, 421 U.S. 723 (1975) 6, 11, 13

Burbrooke Manufacturing Co. Inc. v. St. George Textile Corp., 283 App. Div. 640 (1st Dept. 1954) 15

Commerce Reporting Co. v. Puretec Inc., 290 F. Supp. 715 (S.D.N.Y. 1968) 11

Cusick v. Ifshin, 70 Misc. 2d 564 (1972) 8

Equity National Industries Inc. v. Kates, et al., S.D.N.Y., 72 Civ. 503 2

Globus v. Law Research Service Inc., 418 F.2d 1276 (C.A. 2d 1969) 12

Goodman v. H. Hentz & Co., 265 F. Supp. 440 (N.D. Ill. 1967) 11

Herpich v. Wallace, 430 F.2d 792 (C.A. 5 1970) 6, 7, 10, 13

James v. Gerber Products, 483 F.2d 944 11

Lincoln National Bank v. Lampe, 414 F. Supp. 1270 (N.D. Ill. 1976) 11

McClure v. First National of Lubbock Texas, 352 F. Supp. 454 (N.D. Texas), aff'd., 497 F.2d 49 (C.A. 5 1974), cert. denied, 420 U.S. 930 (1975) 6, 10

Vine v. Beneficial Finance Company, 374 F.2d 627 (C.A. 2), cert. denied, 389 U.S. 970 (1967) 11

Contents

Page

Statutes Cited:

Securities Act of 1933, 15 U.S.C.:

§2(3) 13

§17A 12, 13

§77(a) 12

§77b(3) 13

§78J(b) 12

Securities and Exchange Act of 1934:

§3(a)13 13

§3(a)14 13

§10b 10, 11, 12

§10b-5 ..... 10, 11, 12

Other Authorities Cited:

McKinney's Consolidated Laws of New York, New York Penal Law, §190.40, Vol. 39 8

New York Civil Practice Law and Rules:

§3211(a)(7) 15

§5013 15

52 N.Y.U. L. Rev. 3 (Scheduled for Oct. 1977) 11

In The

Supreme Court of the United States

October Term, 1977

No.

BANKERS TRUST COMPANY,

Petitioner,

vs.

SAMUEL MALLIS AND FRANKLYN KUPFERMAN,

Respondents.

BRIEF FOR RESPONDENTS

QUESTIONS PRESENTED

1. May a bank which has a financial interest in what it knows to be worthless stock, participate in a sale thereof, receive at closing a large portion of the consideration paid by an unsuspecting buyer and escape liability under the Federal Anti-Fraud Securities Laws for the damages suffered?

2. May a pledgee of worthless stock, originally believed by him to be valuable, maintain an action for damages under the Federal Anti-Fraud Securities Laws where foreclosure and sale to obtain "standing" is enjoined and in any event such foreclosure and sale would be an empty gesture?

3. Were the respondents in fact or in law "buyers" of stock rather than pledgees; and, on the facts of this case, is there any difference between the two?

THE PROLOGUE TO FRAUD

Prior to August 25, 1970 one Jerome B. Kates applied to Bankers Trust Company (hereinafter "Bankers") for a $50,000 loan offering some 40,000 shares of the stock of Equity National Industries Inc. (hereinafter "Equity") as collateral. Bankers refused to make the loan, absent a letter of opinion from Kates' counsel as to legal matters relating to the stock, because the stock was both unregistered and subject to a condition (A56). The letter was forthcoming (Appendix to Appellants' Brief, pp. 47-50) but expressed an opinion and belief within the ken of accountants or economists or corporate management rather than on legal matters. Nevertheless, the loan was made.[1]

The condition was not met; within about six months from the time the loan was made, and on March 2, 1971, Atlanta, Georgia, counsel to Equity, the issuer, hand-delivered to Bankers' representative in New York a letter advising that the stock was worthless and the return of the certificates was requested (A95, A97). The parties exchanged other correspondence (A95-A100). In February of 1972, Equity filed suit against Bankers seeking a return of the stock.[2] Because the complaint in this case was

1. The condition to valid issuance of the stock was minimum specified earnings of Take Two Inc., a company owned by Kates and acquired by Equity from Kates in consideration for the issuance of the stock. The letter of opinion of counsel expressed confidence that the minimum earnings figure would be met (Appendix to Appellant's Brief, pp. 47-50). Either Bankers did not obtain the extensive litigation record of Kates and his corporations or they chose to ignore it (A145-A153).

2. *Equity National Industries Inc. v. Kates, et al.*, S.D.N.Y. 72 Civ. 503. In his affidavit submitted to the District Court, Silverman of Bankers asserts that Equity discontinued its litigation against Bankers because "Equity was

(Cont'd)

dismissed at the pleading stage by the District Court for respondents' alleged lack of standing, the record fails to disclose the terms under which Kates had agreed to repay the loan since discovery had not commenced prior to dismissal. In an affidavit submitted in the action commenced by respondents herein in the Supreme Court of the State of New York, Jasper, Bankers' loan officer stated that Kates made regular monthly payments in reduction of the loan and the bank therefore "took no action to sell the collateral" (A57). The statement is curious because in July, 1971, Bankers recovered judgment not only against Kates, but his wife as well, for $54,795.25 (A147). The bank failed to foreclose on the collateral, presumably because it was worthless, and the bank knew it, and the record does not suggest any effort to enforce the judgment. The inference is fair that the bank hoped to be made whole by some disposition of the stock other than through formal foreclosure and sale. In the meantime, it is a fair inference that Bankers was pressing Kates for payment.

THE ANATOMY OF THE FRAUD

Arnold was Mallis' lawyer in another matter.[3] Arnold and one Fowler, a stock broker, met Kates (the record does not disclose how or when) and apparently Kates offered to sell them the stock. Arnold and Kates entered into a buy-sell agreement on February 24, 1972 for this utterly worthless stock for a

(Cont'd)

convinced that it had no action against Bankers Trust" (A105). The statement may be literally true because Equity discontinued the suit upon learning that Bankers had disposed of the stock prior to the time an injunction could be obtained. Equity then instituted suit for injunctive relief against Bankers' successor in interest, the respondents here.

3. Mallis was the victim of an earlier stock fraud and engaged Arnold for the purpose of instituting suit to recover his losses. On this basis appellant argues that Mallis was a "sophisticated" buyer (see Appellant's Brief, n.7, p. 8). Respondents, on the other hand, submit that sophisticated investors do not find it necessary to be plaintiffs in successive fraud suits.

consideration of $181,728.00, Kates warranting its genuiness[4] (A23-A25). The agreement refers to the buyer as "Jack Arnold *as attorney*" (italics added).[5]

Arnold and Fowler proceeded to attempt to find the balance of funds required, a sum in excess of $156,000 to close the transaction. Arnold found the respondents, two Long Island dentists, who made the money available by borrowing it from Franklin National Bank. Arnold, the attorney, and Murfitt, a vice president of the Franklin National Bank, who had approved the loan by Franklin to the respondents, attended the closing with Kates on March 2, 1972 at Bankers Trust Company offices as the representatives of respondents. Fowler was also present as was Nathan Silverman, the attorney for Bankers (A59).

The buyer or "buying group" knew that Bankers Trust Company had an interest in the stock because one of the checks delivered at the closing named Bankers as co-payee (A26). Respondents claim Bankers' name was stricken without their authority from the check (A109). Moreover, the closing was held

4. The attention of the Court is invited to ¶ 7 of the buy-sell agreement between Kates and Arnold (A25) which incorporates a "time of the essence" clause. At page 7 of their brief to this Court the statement, not supported by anything in the record, is made that Bankers Trust Company was served with the summons and complaint in the action filed by Equity to obtain cancellation of the certificates on March 10, 1972. It is fair to assume that at least some of the defendants were served during the month of February and that the "time of the essence" clause was intended to conclude the transaction prior to Equity's action proceeding any further. Assuming that Bankers was indeed not served until March 10, 1972, it does not necessarily follow that it was unaware of the institution of the suit some days or weeks previously and on the contrary, it is fair to assume Bankers was advised by Equity weeks prior to the actual date of service that suit was imminent or had been filed. There has been no development thus far of Bankers' involvement, if any, with the "time of the essence" clause.

5. The significance of this description of Arnold is discussed, *infra*, p. 9. Obviously, he signed in a representative capacity.

in the Legal Department offices of Bankers, one of the most prestigious banks in the City of New York if not the United States. Counsel for Bankers states in an affidavit to the Court below that it allowed its offices to be used as a "convenience" (A106) but the fairer inference is that, as in other "closings" where a bank is interested in and required to consummate a transaction, Bankers, which had possession of the securities and an interest therein, insisted that the closing be held in its own Legal Department. It received at that time and place at least $45,000 (A26) in the form of a check of the Franklin National Bank, the funds having been generated by a loan made by respondents from Franklin National Bank.

Bankers' surrender of these securities on receipt of a large portion of the purchase money in this setting, with its attorney present, gave to the transaction an air of propriety that could hardly be duplicated. This air was fortified by the fact that in the face of the warnings contained on the endorsement side of the certificates that they could not be "sold, transferred, pledged or hypothecated . . ." the bank had accepted their pledge and by the silence of its attorney and by his presence at the sale of the stock the bank in effect certified that it was satisfied in having accepted the securities as collateral; why should the buyer have been wary of treading a path previously tread without mishap by this prestigious bank? Finally, the Kates affidavit (A84) which was sworn to on the date of the closing was apparently requested at the closing by the buyer or his representatives and the same must have been prepared for Kates' signature by a secretary employed in the office of Bankers' Legal Department under the direction of Bankers' lawyer.

Respondents' $156,000 having been divided between Bankers and Kates for the relinquishment of their respective interests in utterly worthless stock, they soon thereafter learned of their plight and were ultimately named as defendants, together with Kates, in an action commenced by Equity in the Delaware Chancery Court (A42-A46) which sought an

adjudication that the stock was worthless and an injunction against further transfer. This relief was apparently granted.

ARGUMENT

INTRODUCTION

A mere recitation of the events giving rise to this litigation is enough to demonstrate that the Court is presented in this case with an outrageous completed fraud in which the sale and transfer of securities and interests therein was the central occurrence and the vehicle by which the fraud was perpetrated. It is therefore unlike *Blue Chip Stamps v. Manor Drug Store*, 421 U.S. 723 (1975) or *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (C.A. 2 1952) where the "buyer" expended nothing. It is unlike *McClure v. First National of Lubbock Texas*, 352 F. Supp. 454 (N.D. Texas), *aff'd.*, 497 F.2d 490 (C.A. 5 1974), *cert. denied*, 420 U.S. 930 (1975) or *Herpich v. Wallace*, 430 F.2d 792 (C.A. 5 1970) where the allegedly fraudulent pledge had not matured into a demonstrable calculated loss. In the case here under consideration, there is a demonstrated loss of a sum in excess of $156,000 the amount paid at closing by the respondents for utterly worthless securities.

The only question is whether respondents' connection with the transaction was sufficiently direct and proximate to conclude that they have "standing" to invoke the federal anti-fraud securities laws. It can hardly be denied that a fraud has occurred and that respondents were the principal victims. Since the question of "standing to sue" relates only to the posture of the respondents, and not to the ultimate liability of Bankers nor the theory under which Bankers may be held,[6] a denial to them of

6. The Second Circuit held not only that respondents were purchasers but that Bankers was a seller by virtue of its release of the pledged shares on receipt of funds of a third party in satisfaction of the pledge. Respondents believe that the reasoning of the Second Circuit is sound in reaching this conclusion; however, even if Bankers were not a "seller" it certainly aided and abetted the seller and may be held liable on that ground.

"standing to sue" would call into question their right to maintain an action for federal securities fraud, on this state of facts, against Kates, an unthinkable result. In this connection, the Court's attention is respectfully invited to the language of *Herpich v. Wallace, supra* at 805:

> "The law of standing has been concerned almost entirely with public law questions such as determinations of constitutionality and review of administrative or other governmental action. Every plaintiff in the federal courts, however, must satisfy the Court that he is a proper party to maintain the action he brings — that he has a personal stake in the outcome of the controversy. *See Flast v. Cohen*, 392 U.S. 83, 101, 88 S. Ct. 1942, 1953, 20 L.Ed.2d 947 (1968); *Baker v. Carr*, 369 U.S. 186, 204, 82 S.Ct. 691, 703, 7 L.Ed.2d 63 (1962). 'The various rules of standing applied by federal courts have not been developed in the abstract. Rather they have been fashioned with specific reference to the status asserted by the party whose standing is challenged and to the type of question he wishes to have adjudicated.' *Flast v. Cohen*, 392 U.S. 83, 101, 88 S.Ct. 1942, 1953, 20 L.Ed.2d 947 (1968). In the context of a plaintiff seeking to invoke a remedy afforded by §10(b) of the Exchange Act and Rule 10b-5 '[t]he first question is whether the plaintiff alleges that the challenged [conduct] has caused him injury in fact, economic or otherwise.' *Association of Data Processing Service Org. Inc. v. Camp*, 397 U.S. 150, 152, 90 S.Ct. 827, 829, 25 L.Ed.2d 184 (1970). The second question is whether 'the interest sought to be protected by the complainant is arguably within the zone of interest to be protected' by §10(b) and Rule 10b-5 thereunder."

I.

Respondents clearly have standing to sue.

(a)

It is true that respondents described themselves as lenders, in their affidavits to the District Court rather than investors, but the documents in the record show them to be "buyers" in the classic sense and both Arnold, the alleged borrower, and Bankers itself, regarded respondents as buyers.

(a) Whatever respondents' and Arnold's (and Fowler's) original intention, their understanding is memorialized in the only document exchanged between them, a letter from Arnold to Mallis, countersigned by Fowler and dated March 3, 1972, the date of the closing, describing Mallis' interest as a "participation in the purchase of 40,384 shares of Equity National Industries Inc." with a limitation of a "profit of $50,000.00 for your participation in this trade." This participation is further described in the letter as an investment (A49).

Repayment to Mallis of his advance of $156,000 is not promised or guaranteed by Arnold or Fowler and neither ever executed a note or other evidence of debt in favor of the respondents or either of them.[7]

(b) Any claim of respondents of debt owing from Fowler

7. Appellant argues (Appellants' Brief, p. 21, n.12) that respondents were to earn "interest" on the "loan" at 383% per annum. The exaction of interest of this character is felonious under the New York law, New York Penal Law §190.40, McKinney's Consolidated Laws of New York, Volume 39. Since the law never assumes a criminal intent, the increment agreed to, $50,000 for 30 days must have been intended as nothing more than a participation in anticipated profit, limited, however, to $50,000. Under the New York cases there is a strong presumption militating against a finding of usury. See, *e.g. Cusick v. Ifshin*, 70 Misc. 2d 564 (1972).

and Arnold to Mallis in the state court action commenced by Mallis against Arnold and Fowler is denied.

(c) The contract of purchase between Kates and Arnold described Arnold, the buyer of record, "as attorney" (A23, A25), a representative term. Arnold describes Mallis' participation as "probably" an investment not a loan in Arnold's sworn testimony taken in the Supreme Court action (A142-A144).

(d) Finally, in his affidavit of January 12, 1973, submitted in support of the motion to dismiss the state court action, Nathan Silverman, the attorney for Bankers who attended the closing and who was associated with Bankers attorney of record, states:

> "On March 3, 1972, the following persons came to our office to close the matter: the defendant Kates, Jack B. Fowler, Jr. a stockbroker (sued herein), Jack J. Arnold (sued herein), the attorney representing the *purchaser*, plaintiff herein, and John A. Murfitt, an assistant vice president of Franklin National Bank where the purchaser had an account and who was to provide the funds for such purchase. The said representative of Franklin National Bank brought with him official checks to pay for the purchase of the said stock. I might mention that as stated above, that our office was offered as a facility to accomodate the parties involved. I did not know and I was never told the name of the purchaser nor was I interested. Also I did not know whether the stockbroker Fowler represented Kates or whether he represented the purchaser and again I was not interested"(A159). (Italics in original).

Thus, according to Silverman he knew that Arnold was not the purchaser; he knew that Fowler was not the purchaser; and he knew that Murfitt of Franklin National Bank was not the purchaser; he knew that the purchaser was someone who had an account at the Franklin National Bank and that that individual was not present at the closing; he did not know the name of the purchaser nor was he interested. The description fits the respondents.[8]

(b)

Assuming, notwithstanding the foregoing, that respondents were in the literal sense not "buyers" but were rather pledgees, they should still not be foreclosed from the protection afforded by the Federal Anti-Fraud Securities Laws.

Herpich v. Wallace, supra, held that a "mere pledge" could not support an action under §10(b) of the Exchange Act and Rule 10b-5 without an allegation of foreclosure and sale. *McClure, supra,* held essentially the same; that is, that the pledge of stock must have culminated in a sale of some kind for these statutes to be applicable. No well-considered case has denied the applicability of this legislation to a plege transaction which, after default, has culminated in a sale through

8. Bankers' dismissal of the state court action was founded on its representation to that Court that it believed at the time of closing that the stock was valuable and that there was no proof it knew or had reason to believe otherwise (A61, A159). The existence of the exchange of correspondence between Bankers and Equity a year prior to closing was not then known to respondents and was withheld by Bankers which made contrary representations as above set forth. Having obtained a dismissal of the state court action on that spurious ground while there conceding that respondents were "purchasers" Bankers now seeks to avoid liability under the federal anti-fraud statutes on the theory that respondents were not "purchasers" while not seriously arguing that appellant did not know the stock was worthless at the time of closing. If for no reason other than to avoid a manifest miscarriage of justice, Bankers should now be estopped from denying that respondents were "purchasers."

foreclosure. Assuming that the views expressed in these opinions ought to be preferred over the more expansive view of the Second Circuit that a pledge of stock is a transaction which is, *per se,* a transaction which is within the coverage of this legislation, the rationale of these cases could be satisfied by a pledgee going through the empty formality of foreclosure and sale of worthless or tainted securities.

In *Lincoln National Bank v. Lampe,* 414 F. Supp. 1270 (N.D. Ill. 1976), plaintiff alleged that the defendant had pledged counterfeit securities to secure plaintiff's loan to defendant. Plaintiff did not foreclose on the securities and sell them prior to bringing suit alleging 10(b) and 10b-5 violations. The *Lampe* court, which ruled with the benefit of the teaching of *Blue Chip, supra,* held that actual foreclosure would be a futile gesture and granted plaintiff standing to sue. *Lampe, supra,* is consistent in concept with *Vine v. Beneficial Finance Company,* 374 F.2d 627 (C.A. 2), *cert. denied,* 389 U.S. 970 (1967), in that in the former, plaintiff was deemed a "constructive seller," and in the latter plaintiff was deemed a "constructive foreclosure." In both cases the Court held that "technical sales" were not necessary to comply with the standing requirement.[9] The case presently before the Court is also like *Commerce Reporting Co. v. Puretec Inc.,* 290 F. Supp. 715 (S.D.N.Y. 1968); *Goodman v. H. Hentz & Co.,* 265 F. Supp. 440 (N.D. Ill. 1967) and the de facto seller exception evolved in such cases as *James v. Gerber Products,* 483 F.2d 944. Were it not for the fact that respondents have been presumably enjoined by the Delaware Chancery Court from foreclosing on the pledge and selling the stock there would not even be occasion to discuss their "standing" for they would have gone through the formalistic step and "futile gesture" of foreclosing and selling.

9. The result reached in this case by the Court below as well as the approach and the result in *Lincoln National Bank v. Lampe, supra,* are exhaustively examined and approved in 52 N.Y.U. L. Rev. 3 (scheduled for distribution in October, 1977).

There is a close correlation between the language of Rule 10b-5, promulgated under the authority of §10b of the Securities and Exchange Act of 1934, 15 U.S.C. §78J(b) and §17A of the Securities Act of 1933, 15 U.S.C. §77(a). The language of both is virtually identical. However, the question of whether a private right of action may be maintained under §17A of the Securities Act of 1933 appears to be an open one, at least in the Second Circuit. *Globus v. Law Research Service Inc.*, 418 F.2d 1276 (C.A. 2d 1969) was a case where the Second Circuit had occasion to compare the two and indeed to compare the 1933 Act with the 1934 Act. The Second Circuit said in *Globus, supra*, at 418 F.2d 1286:

> ". . . courts have endeavored to treat the '33 and '34 Acts in pari materia and construe them as a single comprehensive scheme of regulation. *U.S. v. Morgan*, 118 F. Supp. 621, 691 (S.D.N.Y. 1953); *Brown v. Gilligan Will & Co.*, 287 F. Supp. 766, 775 (S.D.N.Y. 1968); *Rosenberg v. Globe Aircraft Corp.*, 8 F. Supp. 123 (E.D. Pa. 1948); *Lennerth v. Mendenhall*, 234 F. Supp. 59, 62 (N.D. Ohio 1964). Professor Loss has written that the two statutes 'are as closely related as two nominally separate statutes could be.'"

Nevertheless, the Second Circuit found it unnecessary to imply a civil remedy under §17A of the 1933 Act in the *Globus* case simply because it would be duplicative of the relief otherwise granted under §10b of the 1934 Act and Rule 10b-5. In *Architectural League v. Bartos*, 404 F. Supp. 304 (S.D.N.Y. 1975), the Court held that a civil action may not be implied under §17A of the 1933 Act. Therefore, should this Court conclude that respondents do not have "standing" to sue under §10b and Rule 10b-5 because of the definitional term of "seller", etc. as contained in the 1934 Act, respondents respectfully request that this Court indicate whether these respondents, the victims of such outrageous fraud, may maintain an action under

§17A of the 1933 Act under which Bankers was most assuredly a seller and respondents most assuredly buyers under any view of the facts.[10]

In behalf of the respondents, it is respectfully urged that the Second Circuit was correct in reading the 1933 and 1934 Acts in *pari materia* in this case. The legislative history of the Acts indicates that the 1934 Act was intended to broaden the coverage of the 1933 Act rather than to limit its scope.

The definitional distinctions between the 1933 and 1934 Acts of the terms "sale," "sell," "buy" and "purchase" do not necessarily mandate a conclusion either that respondents were not "buyers" or that Bankers was not a "seller" within the meaning of the 1934 Act. The 1934 Act "includes" certain specified transactions within the foregoing terms but does not necessarily exclude others "arguably within the zone of the interests to be protected," *Herpich v. Wallace, supra* at p. 805, quoting with approval from the decision by this Court in *Association of Data Processing Service Org. Inc. v. Campe, supra*. Additionally, appellants gloss over the "or otherwise acquire" and the "or otherwise dispose of" in the definitional language of §3(a)(13) and §3(a)(14) of the Securities and Exchange Act of 1934.

II.

Bankers Trust was a "seller" of securities which were acquired by respondents.

Securities Act of 1933, §2(3), 15 U.S.C. 77b(3) defines a sale as "every contract of sale or disposition of a security or interest in a security, for value." Within this definition Bankers was a seller on March 3, 1972 when it relinquished its security interest in these worthless stocks for a value provided by respondents, at

---

10. This question was expressly left open by this Court in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, at page 733, footnote 6.

least for the purposes of the Securities Act of 1933. It "otherwise disposed of" stock for the purposes of the 1934 Act, and therefore "sold" them. Similarly, Kates "sold" stocks to Bankers within the meaning of the Securities Act of 1933 when he pledged the stock in the first instance; he received value and gave an "interest" in a security, *i.e.*, a security interest. Moreover, it cannot be disputed that Kates "sold" the stock on March 3, 1972 within the meaning of both Acts and Bankers aided and abetted in the consummation of the sale; indeed, the sale could not have been completed absent Bankers' participation.

III.

The sale, purchase and pledge were interdependent.

In any view, the argument of Bankers, repeatedly advanced in their brief to this Court, that the transaction between Kates and Bankers was separate and apart from the transaction between Kates and respondents or those representing them is simplistic and rhetorical. The transactions were simultaneous and interdependent. Neither could have been completed without the simultaneous completion of the other. In the final analysis respondents' money was knowingly accepted by Bankers in satisfaction of Kates' loan and Bankers knowingly allowed respondents to succeed to Bankers' own position as victims of a stock swindle, all in a single sitting. No attempt to fragmentize this single transaction into its component parts can change this simple fact.

IV.

The earlier dismissal of the Supreme Court action is not *res judicata*.

Respondents instituted an action in the New York Supreme Court naming as defendants Bankers Trust Company, Arnold, Fowler, and Kates. The action is still pending as against the

other defendants but has been dismissed on a pleading motion against Bankers. This Court will observe that Bankers moved for an order of dismissal pursuant to New York Civil Practice Law and Rules §3211(a)(7) upon the grounds that the complaint failed to state a cause of action (A91). The motion was granted on that ground and an order of dismissal was signed (A92). It will be observed that the order of dismissal is not upon the merits and in fact the order of dismissal was based upon a defective pleading rather than a defective case.

Rule 5013 of the New York Civil Practice Law and Rules provides:

> "A judgment dismissing a cause of action before the close of the proponents' evidence is not a dismissal on the merits unless it specifies otherwise, but a judgment dismissing a cause of action after the close of the proponents' evidence is a dismissal on the merits unless it specifies otherwise."

It will be observed that the state court order of dismissal does not specify that the same is "on the merits" nor did the dismissal come after the close of plaintiffs' evidence since no evidence was ever presented.

Moreover, the ruling case law of the State of New York is that the doctrine of *res judicata* or collateral estoppel does not apply to a dismissal in a fraud case where the dismissal itself was obtained through fraud. *See, e.g., Burbrooke Manufacturing Co. Inc. v. St. George Textile Corp.*, 283 App. Div. 640 (1st Dept., 1954).

In the affidavit of Jack Jasper, submitted in support of the application of Bankers for a dismissal in the state court action, he, as assistant treasurer of Bankers, told the Court that:

> "For plaintiff to allege that Bankers knew that the legended Equity stock was 'worthless' is a gratuitous statement not borne out by the facts." (A57).

In the affidavit of Nathan Silverman, an attorney associated with Charles Leeds, attorney for Bankers, in support of the application for an order of dismissal by the state court, he stated:

> "Although not germane to the issue of liability on the part of Bankers there is no proof that Bankers knew that the Equity stock was 'worthless.' On the contrary, as will be seen by the annexed affidavit of Jack Jasper, the Equity stock was considered valuable when accepted as collateral and continued to be so considered up to the time of closing on March 3, 1972." (A61).

The truth of both of these statements is called into serious question by the exchange of correspondence between Equity and Bankers during a period commencing March 1, 1971 and April 20, 1971 (A95-A97). The existence of this correspondence was not disclosed when Bankers made its motion to dismiss the state court action and respondents were unaware of its existence since the order of dismissal, being based upon a motion addressed to the pleadings, preceded any discovery.

CONCLUSION

Bankers, having been victimized by a stock swindle, willingly participated in a transaction by which it effectively substituted respondents as the victims in place of itself. It was able to accomplish this by attending a closing at which time its loan was repaid not by Kates, the borrower, but by a third party advancing an original consideration not only to Kates but to Bankers as well in consideration for which Bankers declared the pledge at an end and delivered this worthless stock to the party furnishing the consideration. In behalf of respondents it is respectfully submitted that a miscarriage of justice would occur if the respondents here were denied standing to invoke the federal anti-fraud securities laws. There should be an affirmance.

Respectfully submitted,

s/ Noel W. Hauser
Attorney for Respondents